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IN THE

United States

Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Gary Swan,
Appellant,
vs.
Consolidated Water Company of Pomona etc., et al.,
Appellees.

APPELLANT'S OPENING BRIEF.

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CASES CITED.

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Plaintiff and appellant, a stockholder of the Consolidated Water Company of Pomona, filed his Bill of Complaint in equity in the court below against the Consolidated Water Company of Pomona, its officers and all other stockholders of said corporation.

Plaintiff alleged that he is a citizen and resident of the state of Ohio, and the owner of 65 shares of capital stock of said corporation which has a value of more than Three Thousand ($3,000.00) Dollars. That the corporation and all of the other defendants are citizens and residents of the state of California, and that the corporation is under the control and dominion of G. A. Lathrop, one of the defendants, and that its assets are being dissipated for his benefit and that the corporation had completed the business for which it was organized and that its capital was being diverted into channels not contemplated by its organ-

izers or permitted by its articles of incorporation. Plaintiff prayed for an accounting of the funds and property of the corporation, and for a distribution of its assets and other relief; all of which, together with many facts appurtenant to said cause of action more fully appears in the Bill of Complaint which is set out in full in the transcript of record, pages 3 to 17.

The corporation and its officers filed their motion to dismiss Bill of Complaint "upon the ground that there is insufficiency of fact to constitute a valid cause of action in equity" against them, record pages 16-17. The motion was granted and the court made and entered its decree dismissing said cause, record pages 18-19. From this decree, plaintiff and appellant has appealed to this court.

Argument.

Without attempting to restate the facts set out in Bill of Complaint, we present the following summary:

1. The defendant Lathrop, who to all intents and purposes is the corporation, has been guilty of—

(a) Fraud.

(1) In diverting funds;

(2) In failure to pay dividends;

(3) In using the company's money for his own purposes;

(b) Mismanagement—paying salaries to himself and Mrs. Gridley, in excess of value of services in one case and for none at all in the other;

(c) Betrayal of trust in the above matters and in refusal to vote stock of the Gridley estate, as the interests of the owners, the legatees, required and as they demanded (in writing).

2. Defendant, Lathrop, on behalf of the corporation, attempted to sell and actually delivered substantially all of the corporation's assets to the city of Pomona without the authorization of the stockholders as required by law.

3. The purpose for which the corporation was formed has been accomplished by the completion of its business and sale of all working assets, or has become impossible of attainment because no other water business can now be carried on by it.

4. That defendant, Lathrop, is attempting to embark the corporation in a new and different line of business not contemplated by the stockholders, nor within the purposes of the corporation.

5. That plaintiff has demanded of defendants, Lathrop and the corporation, that steps be taken to wind up the corporation and distribute its assets, and that said Lathrop has refused to bring about or permit a dissolution of said corporation.

6. That said corporation is not being operated, managed or controlled in the interests and for the benefit of the stockholders or in such a way as to give the stockholders or any of them, except said Lathrop, any benefit accruing from the business or earnings of said corporation.

In the court below, defendants urged that the court had no power to take charge of or interfere with the corporation or its business. It would seem that if there is anything of which a court of equity would have jurisdiction, it would be such a case as this.

The Supreme Court of the State of Illinois, in Dodge v. Cole, 97 Ill. 338, in discussing this general question, says:

> "The jurisdiction of a court of equity, does not depend upon the mere accident whether the court has in some previous case, or at some distant period of time, granted relief under similar circumstances, but rather upon the necessities of mankind and the great principles of natural justice, which are recognized by the courts as a part of the law of the land and which are applicable alike to all conditions of society, all ages, and all people . . . . . Where it is clear the circumstances of the case in hand require an application of those principles, the fact that no precedent can be found in which relief has been granted, under a similar state of facts, is no reason for refusing it."

then quotes from Toledo v. Penn, 54 Fed. 746, as follows:

> "Every just order or rule known to equity courts was born of some emergency, to meet some new conditions, and was, therefore, in its time, without a precedent."

then quotes at length and with approval from Fougeray v. Cord, 50 N. J. Eq. 185, 24 Atl. 499, a case similar to our own and says:

> "In the case of a wilful breach of trust, it not only compels the guilty trustee to restore the trust property, but removes it from the possession and control of the custodian who has proved unworthy."

The Michigan Supreme Court dealt with a situation very similar to ours in Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 NW 218, 17 L. R. A. 412, in the course of which it says:

> "Plainly the defendants have assumed to exercise the power belonging to the majority, in order to secure personal profit for themselves, without regard to the interests of the minority. They repudiate the sugges-

tion of fraud, and plant themselves upon their right as a majority to control the corporate interests according to their discretion. They err if they suppose that a court of equity will tolerate a discretion which does not consult the interests of the minority . . . . . But it is also of the essence of the contract that the corporate powers shall only be exercised to accomplish the objects for which they were called into existence, and that the majority shall not control those powers to pervert or destroy the original purposes of the corporators . . . . . When several persons have a common interest in property, equity will not allow one to appropriate it exclusively to himself, or to impair its value to the others . . . . . ."

After more discussion, the Court concludes:

"What is the outlook for the future? This court, in view of the past, can give no assurance. It can make no order that can prevent some other method of bleeding this corporation if it is allowed to continue. If Lohrman be removed, who will take his place? He has the absolute power to determine. Once deposed, he may elect a dummy to take his place . . . . . I think a court of equity, under the circumstances of this case, in the exercise of its general equity jurisdiction, has the power to grant to this complainant ample relief, even to the dissolution of the trust relations. Complainant is therefore entitled to the relief prayed. A receiver will be appointed, and the affairs of this corporation wound up. Defendant Lohrman must account, and pay over all moneys illegally received by him paid to him, or paid out by him from the funds of the corporation."

This is a leading case and has been cited with approval by many courts. We have found no case where it has been criticized.

In Town v. Duplex, etc., 172 Mich. 528, it is cited with approval and the Court says:

> "These cases are exceptional and decision seems to proceed upon the theory that, in the exercise of jurisdiction to relieve from fraud and the effects of breaches of trust, relief may be granted to a suitor, although it involves sequestrating the property and winding up the affairs of a corporation; THE RESULT TO THE CORPORATION BEING AN INCIDENT MERELY OF ADEQUATE AND COMPLETE RELIEF."

To the same effect is Exchange Bank of Wewoka v. Samuel Bailey, 26 Okla. 246, 116 Pac. 812, 39 L. R. A. (N. S.) 1032. It holds:

> "Where the property of a corporation is being mismanaged, or is in danger of being lost to the stockholders and creditors, through mismanagement, collusion or fraud of its officers and directors, a court of equity has inherent power to appoint a receiver for the property of such corporation, and to require the officers to make an accounting upon petition of a minority stockholder therefor."

The Court dealing in New Jersey with a New Jersey corporation in U. S. Shipbuilding Co. v. Conklin, 126 Fed. 132, says:

> "Insolvency of a corporation, coupled with mismanagement of its affairs by its board of directors and such misconduct of the directors as is here charged justify the appointment of a receiver by the court of equity, independently of any statutory authority . . . ."

The case of Enterprise Printing & Pub. Co. v. Craig, 135 N. E. 189 (Indiana), resembled somewhat the case at bar. The Court said:

"It is contended that a court of equity has no power at the suit of an individual to decree a dissolution of a domestic corporation, and to wind up its affairs, unless such extraordinary power has been conferred upon it by the terms of a statute, citing as an Indiana authority Supreme Sitting, etc. v. Baker, 134 Ind. 293. This case which was an action by three stockholders of an insurance company against the company, having for its ultimate purpose the preservation of the resources of the company from the mismanagement of its officers, while the prayer of the complaint was for the dissolution on the ground of its insolvency and the general mismanagement of its officers and the appointment of a receiver to that end, the averments of the complaint were sufficient to sustain the court in the appointment of a receiver and the Supreme Court so held, but saying in the course of its opinion that a court of equity has no power independently of statute to dissolve an insolvent corporation, and saying that there were no authorities cited holding a contrary doctrine and that it knew of none. But the court in that case had no such circumstances to consider as we have here."

The court goes on to say that in that case there was no averment that the delinquent officers owned a majority of the stock, or that they could not be supplanted by other officers chosen by majority of the stockholders, etc., and holding generally that they made no showing that a dissolution of the corporation was necessary by that court, and if they had done so . . . . .

"The court would have been equal to the emergency. It is a maxim of equity that it will not suffer a wrong without a remedy, and the fact that it can find no precedent will not deter it from awarding relief in a proper case."

The judgment appealed from was affirmed. The Court sets out in this language:

> "There was a trial by the court and special findings and conclusions of law in favor of appellee Craig, upon which judgment was rendered, decreeing the appointment of a receiver to take charge of the property involved, to manage and conduct the business until the property could be sold, and to sell the property and divide the proceeds among the stockholders in proportion to the amount of stock held by each."

The Court quotes from Miner v. Belle Isle, *supra,* at some length, approving that case, then says that the general rule is that the court had no power to wind up the corporation in the absence of statutory authority, but that the rule is subject to qualifications, and that in proper cases the court has power to grant ample relief even to the dissolution of the trust relations and cites a large number of authorities.

In Zeckendorf v. Steinfelt, 225 U. S. 445 (an Arizona case), the appointment of a receiver for a corporation was upheld both by the Supreme Court of Arizona and the Supreme Court of the United States.

Appointment of receiver was also approved in Towle v. American Building and Loan Association, 60 Fed. 132, reading page 133, Court says:

> "Should the power be exercised in favor of complainant herein? The case is a peculiar one, the complainants are substantially both depositors and shareholders—the interest of the member is not that simply of a depositor in a bank or a creditor of a corporation —he holds no promise of the corporation for a return of his fund; he is part owner of the fund—has an in-

> terest directly in the fund—and is entitled to a proportional share as owner upon distribution . . . . . that relief will be afforded to stockholder and co-partner upon proper showing is not seriously to be denied."

Courts of equity can and will wind up the business of a corporation, because of negligence, mismanagement and *ultra vires* acts of directors or where the purpose has been fulfilled or has become impossible.

In Porter v. Industrial Information Co., 25 N. Y. Supp. 328, the Court says:

> "Whenever, in the course of events, it proves impossible to attain the real objects for which a corporation was formed, or when the failure of the company has become inevitable, it is the duty of the company's agents to put an end to its operations, and to wind up its affairs; and if the majority should attempt to continue its operations, in violation of its charter, or should refuse to make a distribution of the assets, any shareholder feeling aggrieved will be entitled to the assistance of the courts." .

Klugh v. Coronaca Milg. Co., 66 S. Car. 100 44 S. E. 566;

Merchants Line v. Wagoner, 71 Ala. 581;

Minona Portland Cement Co., 167 Ala. 485;

O'Connor v. Knoxville Hotel Co., 93 Tenn. 708, 28 S. W. 308;

Thoroughgood v. Georgetown Water Co., 9 Del. Ch. 84, P.

In the English case of Cramer v. Bird, 6 L. R. Eq. 143, one railway company's property had been transferred to another company, the debts of the company paid and its surplus remained, Lord Romilly, after referring to certain "Companies' Acts", says:

"None of these acts were intended to supercede the principles of equity, but only to assist the court by giving additional powers to enable persons to enforce equities without those peculiar difficulties arising from a number of shareholders and from the rules of equity, which heretofore have made it impossible for persons in such cases ever to get a decree.

"I am of the opinion that there cannot be a plainer equity than this, that where the functions of a corporation have ceased, the managers of that corporation are bound to account for all moneys belonging to the corporation, and when such moneys are improperly retained this court will make a decree in order that they may be divided among the various members."

The modern corporation is created by its stockholders, not the state—all of them are interested parties and the court will not disorganize the corporation where none of its officers or stockholders are not before the court (*in re* French Bank case, 53 Cal. 495, 551, 2nd par.), but in our case all interested parties are before the court—the corporation, all of its officers and all of its stockholders. Why should the court not give all the relief the wrongs demand?

There is nothing sacred about the corporate form of doing business that exempts a man using it from responsibility to his fellow men and the courts for his moral and legal obligations. Courts of equity are prompt to supply a remedy for every wrong. In some cases, they operate by compelling the individual to make restitution and others by dissolution of the corporation and distribution of its assets. In one case, Fougeray v. Chord, *supra*, a leading Equity Court (New Jersey), transferred from the corporation, one-third of its assets to the abused stockholder and permitted it to continue its corporate existence as the property of the other stockholders with the remainder. In some

cases, the court takes possession of the corporation, in others, compels its officers to perform, but in every case, equity has, or finds a way, to protect the minority stockholder from the fraud of the majority.

In a case such as ours, a court in granting relief said: if it were powerless to appoint a receiver under such circumstances, not only would the law be open to grave reproach for inefficiency, but serious wrongs would go unredressed, and fraud of a stupendous character would escape and go unrebuked . . . . . A stockholder, though owning but a single share, may invoke and set in motion the plenary and far-reaching powers of a court of equity, to investigate, strike down, and strip of its covering any act of the corporation to which he belongs, when that act is tainted with fraud, or is *ultra vires* or illegal. This jurisdiction is one of the most salutary and conservative possessed by a court of equity, and neither the adroitness of the imputed fraud, nor the skill that seeks to hide the illegality of the impeached transaction, will thwart the exercise of the court's coercive and remedial authority.

We submit that the allegations of plaintiff's bill in this action bring him and his cause well within the rules laid down by the foregoing cases, and that this court should not turn him back into the hands of Lathrop to continue to suffer the abuses that have been practiced by him for years, and that the decree of the court below dismissing plaintiff's Bill in Equity should be set aside, and the Court below directed to proceed with the cause.

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